

# City of Midland, Michigan

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## Notes to Financial Statements June 30, 2005

### **Note I - Summary of Significant Accounting Policies**

The accounting policies of the City of Midland, Michigan (the "City") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City of Midland, Michigan:

#### **Reporting Entity**

The City is a municipal corporation governed by an elected five-member City Council (the "Council"), which biannually selects one of its members to serve as mayor. The City operates under a Council-Manager form of government. The accompanying financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Blended component units, although legally separate entities, are in substance part of the City's operations, and data from these units are therefore combined with data from the primary government.

#### **Blended Component Unit**

**Midland Downtown Development Authority** - The Midland Downtown Development Authority (MDDA) was established in 1987 for the purpose of maintaining and renovating the downtown Midland area. The MDDA is administered by a 13-person board, which is appointed by the City Council. Funding for the MDDA is provided by a two-mill levy on property within the district and by tax increment financing. All projects initiated by the MDDA are considered public improvements to the City's infrastructure, parks, or parking facilities. Since the MDDA is used exclusively as a financing source for City facilities, it has been blended into the financial statements of the City as a Special Revenue Fund. The MDDA has a June 30 year end.

#### **Joint Ventures**

**Saginaw-Midland Municipal Water Supply Corporation** - The Saginaw-Midland Municipal Water Supply Corporation (SMMWSC), located approximately eight miles east of the city of Midland, is an authority incorporated by the cities of Midland and Saginaw, Michigan, under Act 233, Public Acts of Michigan, 1955, as amended. The SMMWSC is administered by a six-member board of trustees, each community appointing three members, and is empowered to prepare, adopt, and submit to the legislative bodies of each municipality an annual budget covering estimated revenues, proposed expenditures, and the necessary funds required from each municipality for the next fiscal year.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 1 - Summary of Significant Accounting Policies (Continued)

Funding for the acquisition of property and for the development and improvement of the water supply system is provided by sale of SMMWSC negotiable bonds secured by the full faith and credit of each municipality in a ratio based upon predetermined capacity reserves; 20/43rds for the City of Midland and 23/43rds for the City of Saginaw. Funding for operations is provided by sale of water to the two communities on a consumption basis. The City's equity in the SMMWSC is accounted for in the Water Fund, which is included in the business-type activities column of the statement of net assets.

A summary of the financial information for the year ended June 30, 2005 follows:

Total assets	\$ 3,800,415
Total liabilities	22,231,493
Equity - City of Midland	7,334,383
Equity - City of Saginaw	8,434,539
Total revenues	4,765,607
Total expenses	4,153,312
Net income	612,289

At June 30, 2005, total outstanding bonded debt of the SMMWSC was \$22,000,000. The City was obligated for \$10,232,559 of this total.

**Midland City/County Joint Building Authority** - The City's ownership interest in the Midland City/County Joint Building Authority is accounted for in the governmental activities column of the statement of net assets. The Authority was created as a financing vehicle for the Midland Law Enforcement Center. The Law Enforcement Center is leased from the Joint Building Authority (JBA) by the City of Midland Police Department, the Midland County Sheriff Department, and the Midland County Central Dispatch Authority. The JBA is governed by a three-person board with the City and County each appointing one member and with the third member being mutually appointed. Additional information concerning the Joint Building Authority and its lease with the City is detailed in Note 8 - Leases.

**General** - Complete financial statements, which are audited for the Saginaw-Midland Municipal Water Supply Corporation and the Midland City/County Joint Building Authority, are available from the City Clerk's Office.

The City is unaware of any circumstances that would cause an additional benefit or burden to the participating parties in the near future for any of the above organizations.

### **Note I - Summary of Significant Accounting Policies (Continued)**

#### **Government-wide and Fund Financial Statements**

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. As a general rule, the effect of interfund activity has been removed from these statements. Exceptions to this general rule are charges between the City's water and sewer function and various other functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

#### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

### **Note I - Summary of Significant Accounting Policies (Continued)**

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay current period liabilities.

For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

Property taxes, franchise fees, licenses, interest, and special assessments are susceptible to accrual. Sales and motor fuel taxes collected and held by the State at fiscal year end on behalf of the City are also recognized as revenue of the current fiscal period. Other receipts become measurable and available when cash is received by the City and are recognized as revenue at that time.

The City reports the following major governmental funds:

- The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.
- The Major Street Fund accounts for state-shared revenues relating to construction activities, repairs, and maintenance of all major streets and trunklines.
- The Capital Projects General Construction Fund accounts for construction activities related to non-street projects.

The City reports the following major proprietary funds:

- The Water Fund accounts for the operation and maintenance of the City's water supply system, capital additions, and retirement of bonds.
- The Wastewater Fund accounts for the operation and maintenance of the City's sewage disposal system, capital additions and improvements, and retirement of bonds.
- The Landfill Fund accounts for the operation and maintenance of the City's trash and garbage disposal system.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

- The Real Estate Rental Fund accounts for the operation and maintenance of the City's various senior housing rental properties.

Additionally, the City reports the following Internal Service Funds:

- The Data Processing Fund accounts for the operations of the City's Information Services Department.
- The Equipment Revolving Fund accounts for the rental charges of City-owned equipment to other City departments.
- The Service Center Rental Fund accounts for the operations of the City's Service Center building.
- The Insurance Claims Fund accounts for insurance expenses resulting from property and liability claims.
- The Special Assessment Revolving Fund accounts for the funding of the City's special assessment projects.

Fiduciary Funds are used to account for resources held for the benefit of parties outside the government. Because these funds represent trust responsibilities of the City, these assets are restricted in purpose and do not represent discretionary assets of the City. The Police and Fire Retirement Fund and the Post-Employment Health Care Plan Fund are fiduciary funds of the City. The City's fiduciary activities are reported in separate statements of fiduciary net assets and changes in fiduciary net assets.

Agency Funds are used to account for those held by the City as a custodian for other governments or organizations. Agency Funds have only assets and liabilities representing the parties that are entitled to the assets. The Tax Collection Fund and the Shopping Area Redevelopment Authority Fund are accounted for as Agency Funds.

Private-sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and Enterprise Funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

Amounts reported as program revenue include: (1) charges to customers or applicants for goods, services, or privileges provided; (2) operating grants and contributions; and (3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenue rather than as program revenue. Likewise, general revenue includes all taxes.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's proprietary funds are charges to customers for sales and services. The City also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. The portion intended to recover the cost of infrastructure is recognized as nonoperating revenue. Operating expenses for the proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenues and expenses.

#### **Assets, Liabilities, and Net Assets or Equity**

**Bank Deposits and Investments** - The City's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Investments for the City, as well as for its component unit, are reported at fair value.

**Receivables and Payables** - Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "interfund receivable/payables" or "advances to/from other funds". All other outstanding balances between funds are reported as "due to/from other funds". Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

All trade and property tax receivables are shown net of an allowance for uncollectible amounts. Trade accounts receivable in excess of 180 days comprise the trade accounts receivable allowance for uncollectibles. The property tax receivable allowance at June 30, 2005 is equal to 100 percent of outstanding property taxes over four years old plus 4 percent of outstanding property taxes less than five years old.

Properties are assessed annually as of December 31, and property taxes are billed and become a lien on July 1 of the following year. These taxes are due on September 15 with a final collection date of February 28 before they are added to the county tax roll. The City also bills and collects an amount each December, primarily for schools, county, and college. Also included in the December billing is a tax administration fee, which is revenue to the City. The December billing is due on February 14 with a final collection date of February 28. Penalties and interest are assessed on payments received after the due date.

The 2004 taxable valuation of the City totaled \$2,425,123,300, on which ad valorem taxes levied consisted of 9.23 mills for the City's operating purposes and debt levies equaling .64 mills. The ad valorem taxes levied are recognized in the respective General, Special Revenue, and Water and Sewer Fund financial statements as taxes receivable - current or as tax revenue.

**Inventories and Prepaid Items** - Inventories are valued at cost on an average cost method. The costs of governmental fund-type inventories are recorded as expenditures when consumed rather than when purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements.

**Restricted Assets** - Certain resources set aside for debt service on the City's Enterprise Fund revenue bonds are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants. Additionally, certain resources set aside for closure and postclosure costs for the enterprise landfill operation are classified as restricted assets because their use is limited by applicable State regulations.

### Note 1 - Summary of Significant Accounting Policies (Continued)

**Capital Assets** - Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Projects with total costs of less than \$10,000 are considered repair and are expensed in the year incurred. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Property, plant, and equipment are depreciated using the straight-line method over the following estimated useful lives:

Buildings	50 years
Land improvements	20 years
Infrastructure	10-50 years
Vehicles	3-10 years
Office equipment	10 years
Computer equipment	4 years

**Compensated Absences** - It is the City's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. Vacation pay is fully vested when earned, and sick pay is conditionally vested upon completion of 10 years of service. Upon retirement, employees are paid accumulated vacation and one-half of unused sick days at their hourly rate as of their retirement date.

All sick and vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for the entire amount, current and long-term, is accrued in the government-wide and proprietary financial statements. A liability for these amounts is reported in governmental funds only for employee terminations as of year end.



### **Note I - Summary of Significant Accounting Policies (Continued)**

**Long-term Obligations** - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

**Fund Equity** - In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from these estimates.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 2 - Stewardship, Compliance, and Accountability

**State Construction Code Act** - The City oversees building construction, in accordance with the State's Construction Code Act, including inspection on building construction renovation to ensure compliance with the building codes. The City charges fees for these services. Beginning January 1, 2000, the law requires that collection of these fees be used only for construction code costs, including an allocation of estimated overhead costs. A summary of the current year activity and the cumulative shortfall generated since January 1, 2000 follows:

Shortfall at July 1, 2004		\$	(232,569)
Current year building permit revenue			353,733
Related expenses:			
Direct costs	\$	377,152	
Estimated indirect costs		<u>22,629</u>	
Total construction code expenses			<u>399,781</u>
Cumulative shortfall at June 30, 2005		\$	<u>(278,617)</u>

### Note 3 - Deposits and Investments

Michigan Compiled Laws, Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

### **Note 3 - Deposits and Investments (Continued)**

The City Council has designated nine financial institutions for the deposit of Local Unit funds. The investment policy adopted by the City in accordance with Public Act 20 of 1943 (as amended) authorizes investments in U.S. Treasuries, U.S. agencies and instrumentalities, certificates of deposit, commercial paper (meeting certain rating and maturity requirements), repurchase agreements, investment pools, bankers' acceptances of U.S. banks, and mutual funds. Repurchase agreements must be signed with the bank or dealer and must contain provisions comparable to those outlined in the Public Security Association's model Master Repurchase Agreement. The treasurer may invest in investment pools organized under the Surplus Funds Investment Pool Act of 1982 and under the Urban Cooperation Act of 1967.

For mutual funds, the treasurer may invest in funds registered under the Investment Company Act of 1940. This authorization is limited to securities whose intention is to maintain a net asset value of \$1.00 per share and investment vehicles that are legal for direct investment by a public corporation.

The above-mentioned City investment policy applies to all financial assets of the City except for its Post Retirement Health Care Fund and the Police and Fire Retirement System Fund, which are organized and administered separately. Investments are made pursuant to provisions of the Public Employee Retirement System Investment Act of 1965. Michigan Public Act 314 of 1965 and Michigan Public Act 149 of 1999, as amended, authorize investments in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the trust fund's assets exceed \$250 million), debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The City's cash and investments are subject to several types of risk, which are examined in more detail below:

### Note 3 - Deposits and Investments (Continued)

#### Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The government does not have a deposit policy for custodial credit risk. At year end, the City had \$67,620,089 of bank deposits (certificates of deposit, checking and savings accounts) that were uninsured and uncollateralized. The City believes that due to the dollar amounts of cash deposits and the limits of the FDIC insurance, it is impractical to insure all deposits. As a result, the City evaluates each financial institution with which it deposits its funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

#### Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The City's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
Commercial paper	\$ 8,684,912	0.318
Government bonds	10,905,108	1.634
Asset and mortgage-backed securities	2,380,401	18.893
Corporate bonds	67,089	15.259
International bonds	1,052,822	16.157

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 3 - Deposits and Investments (Continued)

#### Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The City has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Organization
Interlocal Agreement Fund	\$ 224,394	Not Rated	N/A
Bank Investment Pooled Funds	2,054,944	Not Rated	N/A
Commercial paper	8,684,912	AI	S & P
Government bonds	284,571	AAA	S & P
Government bonds	105,406	AA-	S & P
Government bonds	8,146,671	AI	S & P
Money market funds	1,448,115	AAA	S & P
Money market funds	2,841,270	Not Rated	N/A
Mutual funds	1,395,905	Not Rated	N/A
Asset and mortgage-backed securities	2,380,401	AAA	S & P
Corporate bonds	133,657	AAA	S & P
Corporate bonds	462,607	AA-	S & P
Corporate bonds	830,030	A+	S & P
Corporate bonds	815,014	A	S & P
Corporate bonds	951,306	A-	S & P
Corporate bonds	1,388,431	BBB+	S & P
Corporate bonds	1,266,108	BBB	S & P
Corporate bonds	1,089,974	BBB-	S & P
Corporate bonds	734,163	BB+	S & P
Corporate bonds	179,438	BB-	S & P
Corporate bonds	216,363	Not Rated	N/A
International bonds	164,638	A+	S & P
International bonds	34,472	BBB+	S & P
International bonds	467,650	BBB	S & P
International bonds	386,063	BBB-	S & P

# City of Midland, Michigan

## Note 4 - Interfund Transfers, Receivables, and Payables

Interfund transfers reported in the fund statements for the year ended June 30, 2005 were as follows:

Transfers in:	Transfers Out				
	General Fund	Major Street Fund	Local Street Fund	Storm Water Mgmt. Fund	Downtown Develop. Auth. Fund
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -
Major Street Fund	47,150	-	-	-	1,172,405
Local Street Fund	-	669,000	-	-	-
Storm Water Mgmt. Fund	1,400,000	72,368	140,859	-	-
Transportation Fund	611,772	-	-	-	-
Grace A. Dow Library Fund	2,851,779	-	-	-	-
Debt Fund	193,652	-	-	-	155,414
Capital Projects Fund	793,707	-	59,048	2,531,890	-
Water Fund	-	-	-	-	-
Wastewater Fund	-	-	-	-	-
Parking Fund	-	-	-	-	30,000
Special Assessment Rev.	-	-	-	-	-
Total	<u>\$ 5,898,060</u>	<u>\$ 741,368</u>	<u>\$ 199,907</u>	<u>\$ 2,531,890</u>	<u>\$ 1,357,819</u>

The transfer from the General Fund to the Storm Water Management Fund was the second year of a two-year tax levy to fund a \$2.6 million project. The transfer from the General Fund to the Grace A. Dow Memorial Library Fund represents the use of unrestricted resources to finance that program, in accordance with budgetary authorizations. The transfer from the General Fund to the Capital Projects Fund represents funding of construction projects from unrestricted resources, in accordance with budgetary authorizations. The transfer from the Major Street Fund to the Local Street Fund represents the sharing of gas and weight tax revenues, in accordance with Act 51. The transfer from the Storm Water Management Fund to the Capital Projects Fund represents funding of a construction project in accordance with budgetary authorizations. The transfer from the Downtown Development Authority Fund to the Major Street Fund was for road, sidewalk, and streetscape improvements to a major street. The transfer from the Debt Fund to the Wastewater Fund is necessary to transfer an additional millage for debt retirement to the Wastewater Fund, which is the fund that accounts for the related debt.

**Notes to Financial Statements**  
**June 30, 2005**

Transfers Out				Transfers In
Special Activities Fund	Debt Fund	Capital Projects Fund	Total	
\$ -	\$ -	\$ 23,738	\$ 23,738	General Fund
-	-	-	1,219,555	Major Street Fund
-	-	-	669,000	Local Street Fund
-	-	17,851	1,631,078	Storm Water Mgmt Fund
-	-	-	611,772	Transportation Fund
-	-	-	2,851,779	Downtown Dev Auth Fund
-	-	170,067	519,133	Debt Fund
417,406	-	-	3,802,051	Capital Projects Fund
-	-	7,241	7,241	Water Fund
-	1,790,793	2,677	1,793,470	Wastewater Fund
-	-	-	30,000	Parking Fund
-	-	107,347	107,347	Special Assessment Rev
<u>\$ 417,406</u>	<u>\$ 1,790,793</u>	<u>\$ 328,921</u>	<u>\$ 13,266,164</u>	Total

The composition of interfund balances as of June 30, 2005 was as follows:

Receivable Fund	Payable Fund	Amount
General	Special Assessment Revolving	\$ 1,000,000
Special Assessment Revolving	Midland Housing	150,000
Community Development Block Grant	Midland Housing	217,315
Landfill	Real Estate Rental	9,000
Total		<u>\$ 1,376,315</u>

The balance owing from the Special Assessment Revolving Fund to the General Fund represents a return of General Fund monies that were used to initiate the Special Assessment Revolving Fund.

The balance owing from the Midland Housing Fund to the Community Development Block Grant (CDBG) Fund represents remaining balances on mortgages subsidized by the CDBG Fund. The remaining two resulted from loans made for working capital purposes.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 5 - Capital Assets

Capital asset activity for the year ended June 30, 2005 was as follows:

<b>Governmental Activities</b>	<b>Beginning Balance</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending Balance</b>
Capital assets not depreciated:				
Land	\$ 3,159,011	\$ 209,543	\$ -	\$ 3,368,554
Construction in progress	6,884,557	14,175,293	7,120,089	13,939,761
Total capital assets not depreciated	10,043,568	14,384,836	7,120,089	17,308,315
Capital assets being depreciated:				
Major and local roads	3,131,135	5,421,579	28,000	8,524,714
Sidewalks	75,936	183,270	-	259,206
Buildings	21,105,308	1,839,105	1,413	22,943,000
Land improvements	1,231,328	653,941	-	1,885,269
Library circulation materials	6,401,005	587,731	412,915	6,575,821
Equipment	8,198,142	500,295	176,317	8,522,120
Vehicles	12,587,884	1,548,512	917,370	13,219,026
Total capital assets being depreciated	52,730,738	10,734,433	1,536,015	61,929,156
Total capital assets before depreciation	62,774,306	25,119,269	8,656,104	79,237,471
Less accumulated depreciation:				
Major and local roads	72,032	271,764	1,400	342,396
Sidewalks	1,266	7,797	-	9,063
Buildings	8,353,156	443,288	785	8,795,659
Land improvements	169,028	35,502	-	204,530
Library circulation materials	4,386,203	1,297,683	412,915	5,270,971
Furniture, fixtures, and equipment	6,598,239	395,484	163,705	6,830,018
Vehicles	6,675,440	1,189,091	899,367	6,965,164
Subtotal	26,255,364	3,640,609	1,478,172	28,417,801
Net capital assets being depreciated	26,475,374	7,093,824	57,843	33,511,355
Net governmental activities capital assets	\$ 36,518,942	\$ 21,478,660	\$ 7,177,932	\$ 50,819,670



# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 5 - Capital Assets (Continued)

Business-type Activities	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	\$ 2,316,680	\$ -	\$ -	\$ 2,316,680
Construction in progress	3,559,556	1,974,902	4,557,995	976,463
Total capital assets not being depreciated	5,876,236	1,974,902	4,557,995	3,293,143
Capital assets being depreciated:				
Water and sewer lines	66,472,837	5,524,012	27,568	71,969,281
Buildings and building improvements	70,416,670	37,205	13,056	70,440,819
Land improvements	5,545,854	4,219	7,277	5,542,796
Landfill improvements	9,794,093	3,998	-	9,798,091
Equipment	4,978,596	126,309	389,435	4,715,470
Vehicles	597,448	4,800	22,084	580,164
Total capital assets being depreciated	157,805,498	5,700,543	459,420	163,046,621
Less accumulated depreciation:				
Water and sewer lines	22,081,276	1,423,106	1,849	23,502,533
Buildings and building improvements	26,257,342	1,416,048	6,389	27,667,001
Land improvements	913,928	111,765	4,418	1,021,275
Landfill improvements	6,084,043	583,800	-	6,667,843
Equipment	3,451,915	275,055	372,264	3,354,706
Vehicles	345,677	42,319	12,110	375,886
Total accumulated depreciation	59,134,181	3,852,093	397,030	62,589,244
Net capital assets being depreciated	98,671,317	1,848,450	62,390	100,457,377
Net business-type activities capital assets	\$ 104,547,553	\$ 3,823,352	\$ 4,620,385	\$ 103,750,520

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 5 - Capital Assets (Continued)

Depreciation expense charged to programs of the government follows:

Governmental activities:

General government	\$ 438,900
Public safety	260,098
Public works	776,736
Sanitation	87,416
Parks and recreation	328,272
Library	1,557,584
Airport	32,455
Transportation	149,420
Other functions	<u>9,728</u>

Total governmental activities	<u>\$ 3,640,609</u>
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Business-type activities:

Water	\$ 1,137,092
Wastewater	1,422,909
Landfill	674,335
Golf course	136,291
Parking system	38,383
Real estate rental	<u>443,083</u>

Total business-type activities	<u>\$ 3,852,093</u>
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# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 5 - Capital Assets (Continued)

**Construction Commitments** - The City has active construction projects as of June 30, 2005. The projects include streets, water and wastewater system improvements, landfill improvements, and park improvements. At year end, the City's commitments with contractors are as follows:

	Spent to Date	Remaining Commitment	Total Commitment
Airport projects	\$ 412,980	\$ 9,688	\$ 422,668
Landfill projects	-	38,208	38,208
Parks and recreation projects	6,886,149	1,638,275	8,524,424
Sewer projects	181,087	29,174	210,261
Sidewalk projects	106,688	14,072	120,760
Storm sewer projects	2,150,290	176,998	2,327,288
Street projects	1,983,330	1,362,139	3,345,469
Water system projects	269,616	330,709	600,325
Total	<u>\$ 11,990,140</u>	<u>\$ 3,599,263</u>	<u>\$ 15,589,403</u>

Infrastructure assets have not been retroactively recorded, and will be within four years, as allowed under GASB 34.

### Note 6 - Restricted Assets

**Enterprise Funds** - Cash and cash equivalents are restricted within the Water and Wastewater Funds for future debt service obligations and guaranteed deposits, in the amounts of \$1,278,410 and \$1,931,514, respectively. Within each of these funds, an offsetting liability "payable from restricted assets" designates the separation of these assets from unreserved assets. In addition, the Landfill Fund has \$958,244 of restricted assets that are for closure and postclosure costs.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 7 - Deferred Revenue

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received but not yet earned. As of June 30, 2005, the various components of deferred revenue are as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Special assessments not yet due - Internal Service Fund	\$ -	\$ 448,495
Grant money drawn down in excess of expenses - CDBG Fund	-	17,087
Grant money awaiting final program audit and redistribution - Transportation Fund	<u>22,775</u>	<u>1,302</u>
Total deferred/unearned for governmental funds	<u>\$ 22,775</u>	<u>\$ 466,884</u>

### Note 8 - Leases

#### Operating Leases

The City leases its police administration facility and landfill equipment under non-cancelable operating leases. Total costs for such leases were \$390,126 for the year ended June 30, 2005. According to the terms of its lease with the Midland City/County Joint Building Authority, the City's obligation for operating leases amounts to 64.8 percent of total operating expenses of the police administration facility.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 8 - Leases (Continued)

The future minimum lease payments for these leases, including estimates of obligations under the police administration facility lease areas, are as follows:

Years Ending June 30	Amount
2006	\$ 418,773
2007	266,408
2008	236,943
2009	205,248
2010	211,405
2011-2015	<u>1,156,045</u>
Total	<u>\$ 2,494,822</u>

### Capital Leases

The City has entered into a lease agreement with the Midland City/County Joint Building Authority as lessee for financing the construction of police administration facilities. This lease qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments as of the inception date. The total cost of this lease was \$202,583 for the year ended June 30, 2005. Payments under this lease agreement for the year ended June 30, 2005 totaled \$202,583, including \$49,549 of interest charges.

The future minimum lease obligation and net present value as of June 30, 2005 are as follows:

Years Ending June 30	Amount
2006	\$ 212,899
2007	206,200
2008	215,495
2009	207,530
2010	215,703
2011-2013	<u>651,083</u>
Total minimum lease payments	1,708,910
Less amount representing interest	<u>210,456</u>
Present value of minimum lease payments	<u>\$ 1,498,454</u>

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 9 - Long-term Debt

The City issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds, which are direct obligations and pledge the full faith and credit of the City, have been issued for both governmental and business-type activities. Revenue bonds involve a pledge of specific income derived from the acquired or constructed asset to pay debt service and have been issued for business-type activities.

Long-term obligation activity can be summarized as follows:

	Interest Rate Ranges	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental Activities</b>							
<u>General obligation bonds</u>							
1990 Downtown Development Amount of issue: \$660,000 Maturing through: December 2004	6.65%	\$85,000	\$ 85,000	\$ -	\$ (85,000)	\$ -	\$ -
1992 Downtown Development Amount of issue: \$600,000 Maturing through: September 2007	5.65% - 6.05%	\$50,000 - \$100,000	300,000	-	(50,000)	250,000	50,000
2004 Civic Arena Amount of issue: \$6,500,000 Maturing through: May 2030	2.50% - 4.75%	\$135,000 - \$490,000	-	6,500,000	-	6,500,000	445,000
Capital lease (Note 8)			1,651,488	-	(153,034)	1,498,454	212,899
Total bond and capital lease			2,036,488	6,500,000	(288,034)	8,248,454	707,899
<u>Other long-term obligations</u>							
Compensated absences			3,435,689	170,180	(25,938)	3,579,931	1,607,856
Property tax appeals contingency reserve refunds (Note 17)			40,100,762	-	(8,929,696)	31,171,066	-
Total other long-term obligations			43,536,451	170,180	(8,955,634)	34,750,997	1,607,856
Total governmental activities			45,572,939	6,670,180	(9,243,668)	42,999,451	2,315,755

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 9 - Long-term Debt (Continued)

	Interest Rate Ranges	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Business-type Activities</b>							
<u>General obligation bonds</u>							
1989 Sewer Construction: Amount of issue: \$900,000 Maturing through: October 2005	6.00%	\$400,000	\$ 800,000	\$ -	\$ (400,000)	\$ 400,000	\$ 400,000
1990 Sewer Construction: Amount of issue - \$3,400,000 Maturing through: October 2005	4.75%	\$725,000	1,450,000	-	(725,000)	725,000	725,000
2001 Sewer Construction: Amount of issue: \$13,600,000 Maturing through: May 2021	4.50% - 5.25%	\$375,000 - \$1,100,000	12,650,000	-	(425,000)	12,225,000	450,000
2001 Sewer Construction - State Revolving Fund: Amount of issue: \$5,130,000 Borrowed as of 6/30/03: \$4,688,961 Maturing through: April 2022	2.50%	\$205,000 - \$320,000	4,565,886	3,177	(210,000)	4,359,063	215,000
<u>Revenue bonds</u>							
2000 Water Rev Refunding: Amount of issue: \$12,190,000 Maturing through: April 2010	4.80%- 5.30%	\$1,155,000 - 1,390,000	7,110,000	-	(1,335,000)	5,775,000	1,155,000
Total bonds obligations			26,575,886	3,177	(3,095,000)	23,484,063	2,945,000
<u>Other long-term obligations</u>							
Compensated absences			673,114	20,739	(31,086)	662,767	324,727
Landfill closure and postclosure (Note 10)			2,530,000	359,000	-	2,889,000	-
Total other long-term obligations			3,203,114	379,739	(31,086)	3,551,767	324,727
Less current portion payable from restricted assets (Note 6)			3,095,000	-	(150,000)	2,945,000	2,945,000
Total business-type activities			26,684,000	382,916	(2,976,086)	24,090,830	324,727
Total governmental and business-type activities			\$ 72,256,939	\$ 7,053,096	\$ (12,219,754)	\$ 67,090,281	\$ 2,640,482

### **Note 9 - Long-term Debt (Continued)**

The 1990 and 1992 Downtown Development Bonds were issued pursuant to a tax increment financing plan and development plan for the Midland Downtown Development Area under authority of Act 197, Public Act of Michigan, 1975, as amended. Proceeds of the 1990 bonds were used to finance a portion of the construction cost of a downtown parking structure, as described in the plan and located in the Development Area. The 1992 bonds were used to finance a portion of the Downtown Streetscape Project. The bonds are payable from tax increment revenues pursuant to the plan.

The 1989 and 1990 general obligation sewer construction bonds were approved by the voters of the City in a general election held on November 3, 1987. The City Council has passed a resolution to levy a millage to pay approximately 80 percent of the principal and interest cost of these bonds. The remaining 20 percent of the obligation is to be repaid by fees from the users of the municipal sanitary sewage collection and treatment system. The proceeds have been used for the construction of sewer facilities capitalized in the Wastewater Fund or for the construction of the City's storm sewer separation project.

The full faith and credit and the unlimited taxing power of the City are also pledged for payment of principal and interest on the 1993 Sewer Refunding Bonds, the proceeds of which were used to redeem certain portions of the 1989 and 1990 Sewer Construction Bonds to take advantage of lower interest rates.

The 2001 Sewer Construction Bonds were approved by the voters in a general election held on February 22, 2000. The City Council has approved a resolution to levy a millage to pay approximately 60 percent of the principal and interest cost of these bonds. The 40 percent balance of the obligation is to be repaid by fees from the users of the municipal sanitary sewage collection and treatment system. The proceeds are being used for construction of sewer facilities recorded as construction in progress in the Wastewater Fund.

On December 3, 2001, the City Council authorized issuance of general obligation limited tax bonds, series 2001, in the principal sum not to exceed \$5,130,000. The purpose of this issuance is to fund the construction of a storm water retention basin at the wastewater treatment plant. User fees will fund 40 percent of the principal and interest on these bonds, and the remaining 60 percent will be funded by a millage that the City will levy. The full faith and credit and the limited taxing power of the City are pledged for payment of the principal and interest thereon.



# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 9 - Long-term Debt (Continued)

The City has pledged its full faith and credit on the bonded indebtedness of the Saginaw-Midland Municipal Water Supply Corporation, a jointly owned raw water system described in Note 1 - Summary of Significant Accounting Policies.

By statute, the City's general obligation debt is restricted to 10 percent of the equalized value of all property in the City. Certain obligations, such as water revenue refunding bonds, are not subject to this limitation. At June 30, 2005, the City's general obligation debt statutory and legal debt limit amounted to \$242,518,860 and the indebtedness subject to the limitation aggregated \$17,600,438.

Annual requirements to pay principal and interest on the long-term bonds and capital leases outstanding at June 30, 2005 are as follows:

Fiscal Year	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2006	\$ 707,899	\$ 273,889	\$ 981,788	\$ 2,945,000	\$ 1,031,838	\$ 3,976,838
2007	751,200	263,944	1,015,144	1,850,000	919,244	2,769,244
2008	805,495	253,378	1,058,873	1,910,000	834,620	2,744,620
2009	342,530	241,722	584,252	1,940,000	746,339	2,686,339
2010	360,703	243,158	603,861	1,970,000	655,654	2,625,654
2011-2015	1,481,083	1,102,330	2,583,413	4,910,000	2,439,197	7,349,197
2016-2020	1,035,000	806,122	1,841,122	6,380,000	1,252,821	7,632,821
2021-2025	1,310,000	567,906	1,877,906	1,579,063	73,822	1,652,885
2026-2030	1,454,544	239,898	1,694,442	-	-	-
Total	<u>\$ 8,248,454</u>	<u>\$ 3,992,347</u>	<u>\$ 12,240,801</u>	<u>\$ 23,484,063</u>	<u>\$ 7,953,535</u>	<u>\$ 31,437,598</u>

### **Note 10 - Landfill Closure and Postclosure Care Cost**

State and federal laws and regulations require the City to place a final cover on its sanitary landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that the landfill stops accepting waste, the City reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. The \$2,889,000 reported as landfill closure and postclosure care liability at June 30, 2005 represents the cumulative amount reported to date based on the use of 100 percent of the capacity of Area A (32 acres closed in 1991) and cells 1 through 14 (53 acres closed in 2004), and 25 percent of the estimated capacity of cell 15. The City will recognize the remaining estimated cost of closure and postclosure care of approximately \$664,568 as the remaining capacity of cell 15 is filled.

These amounts are based on what it would cost to perform all closure and postclosure care in current dollars. The City expects to close cell 15 during the fiscal year ending June 2010. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

The City is required by state and federal laws and regulations to make contributions to a trust to finance closure and postclosure care. The City is in compliance with these requirements, and at June 30, 2005, cash and cash equivalents in the amount of \$958,244 were held for these purposes, reported as restricted assets on the balance sheet. The City expects that future inflation costs will be paid from interest earnings on these contributions. However, if interest earnings are inadequate or additional postclosure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be covered by charges to future landfill users or from future tax revenue.

The City has also entered into an agreement to provide a letter of credit in favor of the State of Michigan to fulfill certain bonding requirements imposed upon the City, by Michigan law.

### Note 11 - Pension Funds

#### Police and Fire Pension System

**Plan Description** - The Police and Fire Pension System is a single-employer defined benefit pension plan that is administered by the City of Midland Police and Fire Employees Retirement System. This plan covers all police and fire employees of the City. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. At December 31, 2004, the date of the most recent actuarial valuation, membership consisted of 99 retirees and beneficiaries currently receiving benefits, terminated employees entitled to benefits but not yet receiving them, and 92 current active employees. The plan does not issue a separate financial report.

**Funding Policy** - The obligation to contribute to and maintain the system for those employees was established by negotiation with the City's collective bargaining units and requires a contribution from the employees of 7 percent of gross wages for firefighters and 8 percent of gross wages for all other employees. The City's funding policy provides for biweekly employee contributions and monthly employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings.

**Contributions** - Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Please refer to Note 1 for further significant accounting policies.

**Annual Pension Cost** - For the year ended June 30, 2005, the City's annual pension cost was \$929,589, which was equal to the City's required and actual contribution. The required employer contributions were determined as part of an actuarial valuation at December 31, 2004, using the entry age actuarial funding method. Significant actuarial assumptions used include (a) a 7 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, compounded annually, (c) additional projected salary increases of up to 5.2 percent per year, attributable to seniority/merit and (d) no postretirement benefit increases other than 5 percent increases for Police Command members with 25 or more years at 5, 10, 15, and 20 years after retirement. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The overfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is 10 years.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 11 - Pension Funds (Continued)

**Reserves** - As of June 30, 2005, the plan's legally required reserves have been fully funded as follows:

Reserve for employees' contributions	\$ 4,725,285
Reserve for employer contributions	13,090,708
Reserve for retired benefit payment	28,900,139

### Three-year Trend Information

Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contribution	Net Pension Obligation
2003	None	100	None
2004	\$ 194,061	100	None
2005	\$ 929,589	100	None

### Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)	Unfunded (Overfunded) AAL (UAAL)	Funded Ratio (Percent)	Covered Payroll	UAAL as a Percent of Covered Payroll
12/31/02	\$ 55,073,738	\$ 47,343,528	\$ (7,730,210)	116	\$ 5,534,596	(139.7)
12/31/03	51,008,034	49,478,634	(1,529,400)	103	5,582,280	(27.4)
12/31/04	48,603,366	50,436,943	1,833,577	96	5,419,813	33.8

### Municipal Employees' Retirement System of Michigan

**Plan Description** - The City of Midland participates in the Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer, defined-benefit pension plan that covers substantially all employees of the City other than police and fire employees. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. The MERS issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to MERS at 1134 Municipal Way, Lansing, MI 48917.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 11 - Pension Funds (Continued)

**Funding Policy** - The obligation to contribute to and maintain the system for these employees was established primarily by negotiation with the City's collective bargaining units and requires a contribution from the employees ranging from 0 percent to 5 percent of gross wages. The City's funding policy provides for quarterly employee and employer contributions at actuarially determined rates.

**Annual Pension Cost** - For the year ended June 30, 2005, the City's annual pension cost of \$2,495,316 for the plan was equal to the required and actual contribution. The annual required contribution was determined as part of an actuarial valuation at December 31, 2003 using the entry age actuarial funding method. Significant actuarial assumptions used include (a) an 8 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, compounded annually, (c) additional projected salary increases of 0 percent to 8.4 percent per year, attributable to seniority/merit and (d) the assumption that benefits will increase after retirement by 2.5 percent annually, non-compounded. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a five-year period. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is 30 years.

#### Three-year Trend Information

Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contribution	Net Pension Obligation
2003	\$ 1,727,255	100	None
2004	2,347,812	100	None
2005	2,495,316	100	None

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 11 - Pension Funds (Continued)

#### Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)	Unfunded (Overfunded) AAL (UAAL)	Funded Ratio (Percent)	Covered Payroll	UAAL as a Percent of Covered Payroll
12/31/02	\$ 64,917,238	\$ 79,443,565	\$ 14,526,327	82	\$ 11,979,594	121.3
12/31/03	68,149,881	86,011,816	17,861,935	79	12,342,359	144.7
12/31/04	70,567,636	91,177,957	20,610,321	77	12,373,482	166.6

### Note 12 - Postemployment Benefits

The City of Midland provides postemployment health care coverage under a traditionally insured plan to all retired employees and their qualified spouses and other dependents, as mandated by collective bargaining agreements. Currently, these costs are funded on a "pay as you go" basis.

In general, retirees are required to contribute up to 40 percent of the cost of coverage until attaining a specified age (ages 46 to 50 for police and fire retirees, depending on bargaining group, and 65 for all other retirees), at which time the full cost of coverage becomes the obligation of the City.

The net cost to the City of providing postemployment health care coverage follows:

Year	Number of Retirees	Amount
2005	301	\$ 3,993,508
2004	284	3,544,232
2003	270	3,131,547

### Note 13 - Claims, Litigation, and Other Contingencies

In the normal course of its activities, the City becomes a party in various legal actions. Although some actions have been brought for large amounts, the City has not generally experienced significant losses or cost. City management is of the opinion that the outcome of such actions will not have a material effect on the financial position of the City.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 13 - Claims, Litigation, and Other Contingencies (Continued)

The City has received several federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursement to the grantor agency for expenditures disallowed under the terms of the grant. City management believes such disallowances, if any, will be immaterial.

### Note 14 - Enterprise Fund Contractual Revenue

The City supplies large quantities of water to Dow Chemical Company and Dow Corning Corporation under contractual arrangements with each company. Under the Dow Chemical Supplemental Agreement dated March 1, 1979, and Dow Corning Agreement dated July 15, 1985, the companies agree to pay for the variable cost of industrial grade water. In addition, the companies agree to pay a percentage of certain fixed costs, including the principal and interest costs on debt incurred by the City related to plant expansions necessary to meeting the companies' special requirements. These fixed cost payments are due in monthly installments until the year 2010, or until the bonds are paid in full.

The payment percentage is based upon the cost of the facilities required to meet the companies' exact capacity requirements relative to the total cost of the City's initial capacity requirements.

The percentage of the bond principal and interest payments reimbursed by each company follows:

	Dow Chemical Company	Dow Corning Corporation
1992 Saginaw-Midland - Water Revenue Refinancing Bonds	34.00	4.20
1992 Saginaw-Midland - Water Revenue Bonds	34.00	4.20
1993 Saginaw-Midland - Water Revenue Bonds	34.00	4.20
1998 Saginaw-Midland - Water Revenue Refinancing Bonds	34.00	4.20
2000 Water Revenue Refinancing Bonds	37.976	4.667

### **Note 14 - Enterprise Fund Contractual Revenue (Continued)**

Total payments received under these agreements during the fiscal year were \$1,135,813, consisting of principal and interest of \$800,764 and \$335,049, respectively. These payments have been recorded as nonoperating revenue in the City's Enterprise Funds. Under the terms of these agreements, no equity accrues to either company.

Under the terms of the agreement with Dow Chemical Company, the Water Fund shall retain in a Dow Chemical Emergency Repair and Maintenance Fund, \$25,000 to fund Dow's share of non-budgeted repair, replacement, or improvements.

### **Note 15 - Urban Cooperation Act Agreement**

Effective December 30, 1992, the City entered into a 30-year interlocal public agency agreement with the Township of Midland, as authorized by the provisions of Public Act 7 of the Public Acts of the State of Michigan of 1967 (Ex Sess) [MSA 5.4088(1) et seq; MCLA 124.501 et seq].

The agreement provides for (1) the orderly and uncontested annexation to the City of certain property then located in the Township; (2) future sharing, through the year 2022, of revenues derived from the City's levy of property taxes on certain property to be annexed under the agreement; (3) beginning in September 1993, and continuing through the year 2012, the sharing of revenues derived from the City's levy of property taxes on certain commercial and industrial property already located within the City; and (4) extension, at City cost, of water and sewer services by the City to the Township boundary.

The City's obligation under provision 3, above, shall cease if and when total cumulative payments thereunder reach \$15,000,000. The amount of revenue sharing due to the Township by the City under this agreement during the year ended June 30, 2005 was \$350,178.

Due to the tax appeals by the City's three largest taxpayers (see Note 17), the City and the Township have agreed to have the City hold back the portion of the Township's payments in relation to the additional millage levied for the tax appeal reserve. The amount recorded as a liability to the Township in the General Fund is \$2,014,805 as of June 30, 2005.



### **Note 16 - Risk Management**

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City has purchased commercial insurance for medical benefit claims, liability and property claims, airport liability and pension fiduciary liability claims, and participates in the Michigan Municipal Workers' Compensation Pool for employee injury claims.

The Michigan Municipal League risk pool programs operate as common risk-sharing/management programs for local units of government in Michigan. Member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

### **Note 17 - Property Tax Appeals Contingency**

In each fiscal year since 1997, the City has faced tax appeals through the Michigan Tax Tribunal (MTT) from its three largest taxpayers: Midland Cogeneration Venture (MCV), the Dow Corning Corporation, and the Dow Chemical Company.

In each of these years, the City has levied an additional property tax millage, the proceeds of which have been set aside to provide partial funding for the potential liability in the event of an unfavorable resolution of these appeals. The amount reserved each year is based upon an annual assessment of the risk involved in each of the appeals.

Significant developments occurred during the months immediately preceding the beginning of the current fiscal year, which led the City's legal counsel to recommend reducing the City's tax appeal reserve relating to MCV and Dow Corning. A decision was reached by the MTT on the MCV tax appeal for the years 1997 through 2000. While this decision was appealed by both parties, it provided sufficient assurance that the City could reduce its reserve. Similarly, the exchange of appraisals and a pre-trial hearing in the Dow Corning tax appeal provided assurances that the City could reduce its reserve.

Since the inception of the appeals, the City has maintained a promise to adjust the tax millage rate as necessary to refund any unused or unnecessary funds in the reserve. The above reductions resulted in a July 2004 property tax refund to City taxpayers of \$1,692,300, or .68 mills.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2005

### Note 17 - Property Tax Appeals Contingency (Continued)

In October 2004, the City and the Dow Corning Corporation settled a multi-year tax appeal. The settlement provided for an approximate 11 percent reduction of the petitioned taxable values for the tax years under dispute, 1997 through 2004. As of the settlement date, including 2004-2005 tax collections, the City had reserved approximately \$7.2 million in the General Fund, and \$557,000 in Special Revenue Funds to pay potential liabilities as a result of an unfavorable settlement from this tax appeal. The actual settlement resulted in distributions of \$1,914,997 from the General Fund and \$117,470 from Special Revenue Funds. The balance of the amount that the General Fund had reserved for the Dow Corning Corporation settlement was returned to City taxpayers through a millage reduction in July 2005. The balance in Special Revenue Fund reserves will be allocated to future projects.

MCV and Dow Chemical have both filed petitions necessary to appeal their 2005 assessments. It is not currently known how long it will take to settle or adjudicate these two appeals. From 1997 through 2004, the annual combined taxable value under dispute of these two appeals, in millions of dollars, was approximately \$502, \$498, \$505, \$465, \$457, \$487, \$483, and \$521. If granted, in their entirety, the requested adjustments would result in a City refund of property tax and administrative fees of approximately \$48 million.

A summary of the City's General Fund tax appeal reserve and millage are illustrated below:

Fiscal Year	Tax Year	Contribution to Tax Appeal Reserve	Special Millage
1996-97	1996	\$ -	0.00
1997-98	1997	5,029,000	2.30
1998-99	1998	5,834,300	2.49
1999-00	1999	8,063,196	3.24
2000-01	2000	9,226,004	3.64
2001-02	2001	5,457,371	1.94
2002-03	2002	1,255,029	1.44
2003-04	2003	5,235,900	2.13
2004-05	2004	(1,682,366)	(0.68)
Subtotal		38,418,434	
Refunded to Dow Corning		(1,914,997)	
Reserve balance		<u>\$ 36,503,437</u>	

### **Note 17 - Property Tax Appeals Contingency (Continued)**

This reserve will eventually be paid out in satisfaction of these appeals and/or returned to City taxpayers through future millage reductions. Included in the above reserve balance is \$5,332,371, which is the remaining reserve balance for the Dow Corning tax appeal, after Dow Corning was paid its refund.

For reporting purposes in the government-wide statements, the balance of the Dow Corning reserve, which was refunded to taxpayers in July 2005, is reported as unrestricted net assets. The remaining reserve balance, or \$31,171,066, is reported as a long-term liability.

In addition, the City's Special Revenue Funds tax appeal reserve balance, as of June 30, 2005, was \$1,906,718. This amount is not deemed to be refundable, so it will only be paid out in the event of an unfavorable outcome to the tax appeals.

### **Note 18 - Upcoming Reporting Change**

The Governmental Accounting Standards Board has recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The new rules will cause the government-wide financial statements to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. The new pronouncement is effective for the year beginning July 1, 2008.

### **Note 19 - Subsequent Events**

Pursuant to resolutions adopted by the City Council on July 11, 2005 and August 22, 2005, on September 13, 2005, General Obligation Unlimited Tax Refunding Bonds of \$9,480,000 were sold. They were issued for the purpose of refunding that portion of the City's outstanding General Obligation Unlimited Tax Bonds, Series 2001, dated as of April 1, 2001, maturing May 1 in the years 2012 through 2021, inclusive, to take advantage of lower interest rates. The terms of the refunding issue are consistent with the original issue as the final payment will be made during 2021. See Note 9 for information related to the original bond issue.